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Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research & Planning Division

Friday
(Noon)

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Chairman Volcker testified before the House Banking Committee this week and seems to have said all the right things to calm the financial markets. At the same time, the Federal funds rate eased back from the 9% level it had flirted with; as a result, the mood in the domestic markets is quite a bit more bullish than it has been. For the time being, the stock market and bond market are not giving off conflicting signals. While such sympathetic movements are reassuring, they fall short of being guarantees.

Certainly the Volcker testimony was a focal point. The Chairman repeated that the money supply numbers were hard to read because of various distortions. He offered the observation that if he were setting loan rates at a bank, he would set them lower at this time. He also stated that interest rates were too high to allow a sustainable recovery to develop. Together, these statements were reassuring to the market. They indicate that the Chairman is concerned about the recovery and that interest rates are in some sense too high. The market has taken from this some direction, but is the expectation for too much too soon? What is the Fed likely to do?

The Fed appears to have put the funds rate above the discount rate before quarter-end. This was to acknowledge the fast growth of money. I don't think this readjustment is about to be reversed. But the markets seem to have pushed rates lower in response to the generally encouraging statements by the Chairman and because expectations are for some very good March and early April money supply numbers--across all the M's. The Fed has strengthened the seasonals on M1 so much that the usual April money bulge is likely to be gone. For example, applying this year's seasonal factors to last year's money supply lowers M1's growth in April of last year by a 10% annual rate compared with the statistics as originally released. The prospect for some good news on money supply has encouraged the long end of the market and dragged the short-term rates along for the ride.

Yet none of this means that the Fed is about to act quickly to lower the discount rate or to encourage cheaper Fed funds. The Fed wants the longer rates down but will probably remain constrained in what it does with the funds rate by the developments in money growth. Since seasonal adjustment procedures do not create or destroy money, the Fed will have to give us back more money growth in seasonal factors for other months to compensate for April. Indeed, the months immediately after April now have seasonal factors that will strengthen money growth beyond what was done by last year's adjustments. Money growth will likely be affected by the mid-year tax cut, which will bring late-year growth to the economy and spur money demand. The net result of these potential pressures is to keep the Fed wary of loosening rates now.

Although the long-term market may rally on the realization of good money supply numbers, short-dated certificates of deposit are already at so small a premium to Fed funds that they are almost certainly in for a correction. April may prove to be very difficult for the short-term market for this reason. Good money supply numbers can succeed in rallying the long end of the market, but only the Fed can move the short-dated instruments lower from current levels. I don't think the Fed will oblige.

Robert A. Brusca

Irving Trust

Market Yields

	4/15/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.63	8.75	15.25
Repurchase Agreements	8.63	8.75	15.25
U.S. Treasury Issues			
Bills			
3 months	8.39	8.61	13.30
6 months	8.69	8.90	14.00
1 year	8.93	9.06	14.15
Coupons			
2 years	9.49	9.68	14.30
4 years	9.86	10.03	14.02
7 years	10.21	10.40	13.90
10 years	10.32	10.50	13.75
Long Bond	10.38	10.55	13.25
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.55	8.80	14.75
3 months	8.55	8.80	14.65
6 months	8.70	8.95	14.60
1 year	9.10	9.30	14.60
Banker's Acceptances			
1 month	8.60	8.85	14.70
3 months	8.60	8.85	14.65
6 months	8.70	8.90	14.65
Eurodollar Deposits			
1 month	9.00	9.44	15.38
2 months	9.13	9.50	15.38
3 months	9.13	9.56	15.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.76	8.63	15.13
1 month	8.68	8.81	15.02
3 months	8.81	8.81	14.86
Bank Holding Companies			
1 month	8.68	8.81	14.10
Dealer Placed:			
3 months	8.78	8.97	15.26
New AA Corporate Utility Bond	11.65	11.85	16.13
Tax Exempt			
6 month Project Notes	4.60	4.60	8.10
1 year AAA Bond	4.75	5.25	8.00
5 year AAA Bond	6.50	6.50	9.25
20 year AAA Bond	8.25	8.85	11.70

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629